

**Letter of Findings Number: 07-0177
Sales and Use Tax
For the Tax Period 2004 -2005**

NOTICE: Under [IC 8 4-22-7-7](#), this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales and Use Tax -Imposition of Use Tax.

Authority: IC § 6-8.1-5-(c); IC § 6-2.5-2-1; IC § 6-2.5-3-2(a); IC § 6-2.5-3-2(c)(l).

The Taxpayer protests the imposition of use tax.

II. Sales and Use Tax -Imposition of Use Tax on Utilities.

Authority: IC § 6-2.5-4-5(b)(c); IC § 8 6-2.5-5-3(b).

The Taxpayer protests the imposition of use tax on utilities.

III. Tax Administration -Negligence Penalty.

Authority: IC § 6-8.1-1 0-2.1; [45 IAC 15-1](#) 1-2(b)(c).

The Taxpayer protests the imposition of the negligence penalty.

STATEMENT OF FACTS

The Taxpayer is a restaurant. Pursuant to an audit for the years 2004-2005, the Indiana Department of Revenue assessed additional use tax and interest. The Department also gave the Taxpayer credit for sales taxes the Taxpayer had incorrectly paid on certain exempt items. The Taxpayer protested the assessments and penalty. This Letter of Findings results.

I. Sales and Use Tax -Imposition of Use Tax.

DISCUSSION

The Department assessed use tax on several invoices where there was no indication that, sales tax had been paid. These invoices were for contractor services, water, banking supplies, and office supplies. The Taxpayer protested these assessments contending that sales taxes had been paid even if the sales taxes were not itemized on the invoices.

Tax assessments are presumed to be valid. IC § 5 6-8.1-5-1 (c). The Taxpayer bears the burden of proving that any assessment is incorrect. *Id.*

Indiana imposes a sales tax on the transfer of tangible personal property by a retail merchant in a retail transaction. IC § 5 6-2.5-2-1. Indiana imposes a complementary excise tax, the use tax, on tangible personal property purchased in a retail transaction and stored, used, or consumed in Indiana. IC § 8 6-2.5-3-2(a). The use tax is not due if the sales tax has already been paid on the purchase. IC § 6-2.5-3-2(c)(1).

The Taxpayer presented letters from some of the vendors indicating that the vendors had collected sales tax or paid their applicable income taxes. These letters are not adequate to sustain the Taxpayer's burden of proving that sales taxes were paid by the Taxpayer at the time of purchase.

FINDING

The Taxpayer's protest is respectfully denied.

II. Sales and Use Tax -Imposition of Use Tax on Utilities.

DISCUSSION

The Department audited the Taxpayer's use of natural gas and electricity. The Department found that forty-six percent of the natural gas used by the Taxpayer was used for an exempt purpose. Therefore, the Department assessed use tax on fifty-four percent of the natural gas used by the Taxpayer. The Department determined that forty-eight percent of the electricity the Taxpayer used was used for an exempt purpose. Therefore, the Department assessed use tax on fifty-two percent of the electricity used by the Taxpayer. The Taxpayer protested these assessments. The Taxpayer determined that over fifty percent of the natural gas and electricity were used for exempt purposes. The Taxpayer argued that since both the natural gas and electricity were predominately used for exempt purposes, there should be no sales or use tax assessed on the Taxpayer's use of these utilities.

Sales and use taxes are assessed on the transfer or use of tangible personal property. *Id.* Services generally are not subject to either the sales or use tax. There are, however, certain services which are statutorily defined as a retail sale subject to the sales and use taxes. The sales of natural gas and electricity by a public utility are specifically defined as retail transactions subject to the sales and use taxes. IC § 6-2.5-4-5(b). Property that is directly used in the direct production of the Taxpayer's product for sale is exempt from the sales and use taxes. IC § 6-2.5-5-3(b). If the natural gas or electricity are predominately used for a purpose that is exempt from the sales and use taxes, then all of the natural gas and electricity are exempt from the sales and use taxes. IC § 6-2.5-4-5(c)(3). The Taxpayer's product for sale is prepared meals. Equipment that is directly used in the direct

production of the meals is exempt from the sales and use taxes. If over fifty percent of the Taxpayer's electricity and natural gas usage is for the exempt purpose of producing the meals served to the public, then the Taxpayer's total utility usage is exempt from the sales and use taxes.

The Department conducted an audit on the Taxpayer's usage of natural gas. First the Department determined how much natural gas the Taxpayer used each month. Then the Department determined how much gas was used in the non-heat months -June, July, and August. The Department considered the natural gas usage during those months to be the gas actually directly used in the direct production of the Taxpayer's product -meals for patrons. The Department then annualized this exempt amount of natural gas to determine the annual amount of natural gas used for non -heating purposes. There were, however, two flaws in the Department's audit. First, part of May and September would also be non- heating periods that should have been accounted for. Also, the amount of natural gas used by the restaurant in July is very low because the restaurant is always closed for two weeks of vacation in July. An appropriate amount for July should have been determined by averaging the natural gas usages of June and August. When that natural gas usage amount for July is added to the June and August amounts and annualized, the percentage of natural gas used in an exempt manner is more than 50 percent of the total amount of natural gas used by the restaurant. Since the Taxpayer used the natural gas predominately for exempt purposes, the Taxpayer did not owe sales or use taxes on its natural gas.

The Department also conducted audit of the Taxpayer's electricity usage. The Department listed the production items that used electricity. Then a load factor representing the amount of time the item was used in production of food for sale was assigned to each item. From this information the electricity directly used in the direct production of the food was calculated at forty-eight percent. Therefore, the Department assessed use tax on fifty-two percent of the Taxpayer's electricity. The Department failed, however, to list several electrical items directly used in the direct production of food. These items included the orange juicer, three microwave ovens, root beer production equipment, and the pie cooler. The three microwaves were each used one hour a day for cooking such as precooking vegetables for soup and melting cheese on eggs and coney dogs. The restaurant made its own pies, including custard and other pies that need to set up. The pie cooler provided the cooling necessary for the setting up of custard, jello, and pudding. This cooling directly affected the production of the pies, i.e. the cooler was not just used to maintain the proper temperature. The orange juicer produced orange juice from oranges. The root beer equipment produced root beer. The addition of these items of exempt production equipment pushes the Taxpayer's exempt usage of electricity above fifty percent. Since the Taxpayer's usage of electricity was predominately for exempt purposes, the Taxpayer did not owe sales or use taxes on electricity.

FINDING

The Taxpayer's protest is sustained.

III. Tax Administration -Negligence Penalty.

DISCUSSION

The Taxpayer protested the imposition of the ten percent negligence penalty pursuant to [IC 8 6-8.1-1 0-2.1](#). Indiana Regulation [45 IAC 1 5- 11-2\(b\)](#) clarifies the standard for the imposition of the negligence penalty as follows:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a----- taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The standard for waiving the negligence penalty is given at [45 IAC 15-11-2\(c\)](#) as follows:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

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The Taxpayer provided substantial documentation to indicate that its failure to pay the assessed use tax was due to reasonable cause rather than negligence.

FINDING

The Taxpayer's protest to the imposition of penalty is sustained.

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